

# OVERVIEW OF THE 2007-08 BUDGET BILL

Senate Bill 54

*As Introduced*

Senate Committee on Budget and Fiscal Review

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## California State Senate

COMMITTEE  
ON  
BUDGET AND FISCAL REVIEW

ROOM 5019, STATE CAPITOL  
SACRAMENTO, CA 95814

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DIANE VAN MAREN  
SEIJA VIRTANEN

COMMITTEE ASSISTANTS  
GLENDA HIGGINS  
ROSE MORRIS

(916) 651-4103  
FAX (916) 323-8386



January 24, 2007

Dear Colleague:

I am pleased to forward a copy of the *Overview of the 2007-08 Budget Bill*, which has been prepared by the staff of the Senate Budget and Fiscal Review Committee. The document is intended to provide a working understanding of the proposed budget by providing greater subject information and identification of issues. This document, as well as further analysis by the Legislative Analyst's Office, will provide the basis for budget hearings throughout spring.

In the first section, we provide an overview of the state's fiscal condition. The next section, entitled "Budget Highlights," is organized by budget subcommittee, and details the budget proposals for most departments and agencies. If you are looking for a specific department or agency, there is an index at the end of the "budget highlights" section.

In the Appendix, we include a working timeline for completing the budget and a list of budget committee consultants and their respective areas of expertise.

If you have questions, please do not hesitate to contact me.

Sincerely,

DENISE MORENO DUCHENY  
Chair

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# *SUMMARY OVERVIEW*

On January 10, the Governor presented his proposed 2007-08 budget. Spending from all funds (General Fund, special funds, and bond funds) totals \$143.4 billion. The Governor's proposed budget contains a total of \$104.5 billion in available General Fund resources. The budget proposes \$103.1 billion in General Fund expenditures, with an available year-end reserve of \$2.1 billion (this is a combination of the traditional Special Fund for Economic Uncertainties of \$590 million and \$1.5 billion in the Budget Stabilization Account (BSA) created as a result of Proposition 58).

Overall, General Fund revenues are estimated to be \$6.8 billion or 7.2 percent greater than what was projected when the current-year budget (AB 1801 – Chapter 47, Statutes of 2006) was passed in late June 2006. The Governor's budget summary indicates that revenues were exceptionally strong in 2006, but are projected to grow more moderately in 2007 and 2008.

The Governor proposes to increase new General Fund expenditures by approximately \$1 billion, or 1 percent above the revised 2006-07 level. This includes a \$595 million General Fund appropriation for early repayment of the Economic Recovery Bonds (ERBs) – this appropriation is in addition to the automatic repayment of approximately \$2.5 billion to retire ERB debt.

The proposed budget is not without potential risks and uncertainties because the budget balances new spending and closes the General Fund shortfall with \$3.4 billion in revenue assumptions, major reductions in various programs, and fund shifts that the Legislative Analyst's Office (LAO) indicates "...raise a number of serious policy and legal issues, which may make their implementation problematic." According to the LAO, the overall downside risks in the proposed budget could exceed the amount of available reserves. A cursory review of the proposed budget by the LAO raises three categories of concern:

- First, the budget assumes the state will prevail in its appeal of two court cases – the legality of using pension obligation bonds to fund an ongoing state expense and the lack of funding for a 2003 CalWORKs cost-of-living adjustment (which was triggered as a result of Governor Schwarzenegger rolling back the VLF tax increase). In addition, there may be legal issues regarding the proposed budget's use of Public Transportation Account (PTA) spillover funds.
- Second, some budget assumptions may be overly optimistic. For example, the LAO indicates that additional tribal gaming revenues appear to be overstated and the shift of PTA spillover funds which are dependent on gasoline prices that have fluctuated over the past year may make the use of these funds for ongoing purposes unreliable.
- Third, baseline assumptions may be unrealistic. At this point, recent revenue and economic information have been mixed and do not support the administration's higher revenue estimates; however, better analysis of year-end tax related information will provide a clearer

picture. In addition, property tax growth is estimated at 10 percent over the current year – which is very healthy, despite the current slowdown in the real estate sector. Any shortfall in property tax projections relative to the budget estimate will require a dollar-for-dollar offset in General Fund expenditures.

The Governor’s budget summary does acknowledge that economic growth will likely be modest in the first half of 2007, with a possibility of a slight increase in unemployment. The Department of Finance (DOF) indicates that the second half of 2007 should bring improved growth as state and national housing sectors begin to pull out of their slowdown; in addition, DOF believes both economies should improve further in 2008. A number of measures of the California economy, while showing signs of slowing, are strong—personal income, taxable sales, private-sector nonresidential and public works construction, and state exports.

Finally, the administration has highlighted that the proposed budget has eliminated the “operating” deficit – the difference between annual revenues and annual expenditures. Upon closer examination of the proposed budget, the LAO concludes that even if all the budget proposals were adopted and assumed savings were realized, the state’s projected gross operating or “structural” deficit would be reduced by only approximately one-half to around \$2.5 billion. However, the LAO has pointed out that the fiscal benefits of many of the budget’s proposals are overstated; meaning the decline in the operating deficit would be significantly less.

## General Fund Summary

**Revenues:** The Governor's budget estimates General Fund revenues and transfers to be approximately \$101.3 billion, an increase of \$6.8 billion, or 7.2 percent, above the revised 2006-07 estimate of \$94.5 billion. Total resources available, in 2007-08, from all sources (including a carry forward balance of \$3.2 billion from 2006-07) are estimated at \$104.5 billion.

**Expenditures:** The budget proposes General Fund expenditures of \$103.1 billion in 2007-08. This is an increase of \$1 billion, or 1 percent, over the revised 2006-07 figure of \$102.1 billion.

<b>Proposed 2007-08 General Fund Summary (in millions)</b>		
	<b>Revised <u>2006-07</u></b>	<b>Proposed <u>2007-08</u></b>
<b>PRIOR YEAR BALANCE</b>	<b>\$10,816</b>	<b>\$3,198</b>
Revenues and transfers	94,519	101,278 <sup>a</sup>
<b>TOTAL RESOURCES AVAILABLE</b>	<b>\$105,335</b>	<b>\$104,476</b>
Non-Proposition 98 Expenditures	\$61,325	\$61,951 <sup>a</sup>
Proposition 98 Expenditures	<u>40,812</u>	<u>41,190</u>
<b>TOTAL EXPENDITURES</b>	<b>\$102,137</b>	<b>\$103,141</b>
<b>FUND BALANCE</b>	<b>\$3,198</b>	<b>\$1,335</b>
Encumbrances	\$745	\$745
Special Fund for Economic Uncertainties (Traditional reserve)	\$2,435	\$590
Budget Stabilization Account (BSA)	\$472	\$1,495
<b>TOTAL AVAILABLE RESERVE</b>	<b>\$2,925</b>	<b>\$2,085</b>

<sup>a</sup> A total of \$2.1 billion will be transferred to the BSA consistent with Proposition 58. Of this amount, one-half will remain in the BSA for future purposes (shown as a reduction in revenue) and one-half will be transferred to accelerate the retirement of Economic Recovery Bonds (shown as an increase in expenditures).

<b>Proposed 2007-08 General Fund Revenue By Source (in millions)</b>			
<b><u>Source</u></b>	<b><u>Revised 2006-07</u></b>	<b><u>Proposed 2007-08</u></b>	<b><u>Year-to-Year % Change</u></b>
Personal Income Tax	\$52,042	\$55,598	6.8%
Sales Tax	27,775	29,347	5.7%
Corporation Tax	10,311	10,816	4.9%
Other	<u>4,391</u>	<u>5,516</u>	<u>25.6%</u>
<b>TOTAL</b>	<b>\$94,519</b>	<b>\$101,278</b>	<b>7.2%</b>

<b>2007-08 General Fund Solutions (in millions)</b>	
<b>Budget Assumption</b>	<b>Amount</b>
• Shift Public Transportation Account Spillover to Backfill General Fund Purposes	\$1,111
• Anticipated Revenues from Tribal Gaming Compacts	\$506
• Various proposals in CalWORKs – including elimination of child-only benefits after a specified time period and restriction of safety net grants	\$324
• Suspension of CalWORKs cost-of-living adjustment (COLA)	\$140
• Shift Stage 2 Child Care to Proposition 98	\$269
• Eliminate Teacher Tax Credit and "Yacht loophole"	\$200
• Replace General Fund with bond funds for levies and parks deferred maintenance	\$280
• Corrections reforms	\$100
• Eliminate state funding for Homeless Mentally Ill	\$55
• Unallocated reduction	\$100
• Other miscellaneous policy savings	\$315
<b>Total</b>	<b>\$3.4 billion</b>

## Total General Fund Spending Concentrated in Four Areas

Four policy areas account for approximately 90 percent of General Fund spending contained in the Governor's Budget. The table below identifies the relative spending in these areas. Specifically, in the proposed 2007-08 budget:

- K-14 Education (which includes community colleges) under Proposition 98 is anticipated to expend \$41.2 billion, accounting for 40 percent of the General Fund spending;
- Health and Human Services expenditures are anticipated to be \$29.8 billion, accounting for 29 percent of the total;
- Higher Education (UC, CSU, and Student Aid Commission) expends \$11.1 billion, accounting for almost 11 percent of the total; and
- Corrections and Rehabilitation (formerly Youth and Adult Corrections) receives \$10 billion, accounting for approximately 10 percent of the total.

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### Proposed 2007-08 General Fund Expenditures (in millions)

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<u>Major Program Area</u>	<u>Revised 2006-07</u>	<u>Proposed 2007-08</u>	<u>Year-to-Year % Change</u>
Education – Proposition 98 (K-12 / Community Colleges)	\$40,812	\$41,190	0.9%
Health and Human Services	29,797	29,848	0.2%
Higher Education (UC/CSU/Other)	10,281	11,058	7.6%
Corrections and Rehabilitation (formerly Youth and Adult Corrections)	9,183	9,989	8.8%
All Other	<u>12,064</u>	<u>11,056</u>	<u>-8.4%</u>
<b>TOTAL</b>	<b>\$102,137</b>	<b>\$103,141</b>	<b>1%</b>



## Proposed 2007-08 Budget -- Major General Fund Changes

- Proposes Proposition 98 funding of \$56.8 billion for K-14 education. This provides an increase of \$1.8 billion (3.3 percent) above the revised 2006-07 Budget. This enables the administration to fund a 4.04 percent COLA for K-12 and community colleges. In addition, the Governor proposes to shift \$627 million in funding for the home-to-school transportation program from Proposition 98 to the Public Transportation Account (PTA). In making this shift, the administration proposes to re-bench the Proposition 98 minimum guarantee downward by \$627 million to reflect savings to the state General Fund.
- Removes \$269 million in federal TANF monies from CDE child care programs and instead funds the entirety of Stage 2 and Stage 3 child care obligation exclusively with General Fund Proposition 98 dollars.
- Provides \$345 million combined for the University of California and the California State University – this includes \$120 million for 2.5 percent growth and \$225.5 million for a four percent General Fund increase. The budget increases student fees by 7 percent at UC and 10 percent at CSU. However, the budget eliminates all state funding for student academic preparation and education programs at both UC and CSU.
- Reduces funding for the California Work Opportunity and Responsibility to Kids (CalWORKS) by \$465 million. The main components of these changes include restricting safety net grants (\$176 million), imposing full family sanctions, eliminating grants for children of CalWORKs ineligible parents (\$160 million), and suspending a cost-of-living adjustment (\$140 million).
- Proposes to cap the state's contributions to wage and benefit increases for In-Home Supportive Services (IHSS) resulting in a reduction of \$14 million General Fund.
- Reduces funding by \$60 million (50 percent of current level funding) for Proposition 36, the Substance Abuse and Crime Prevention Act of 2000 (SACPA). The budget would increase funding by \$35 million to the Substance Abuse Offender Treatment Program.
- Provides \$217 million to fully fund a 4.2 percent Supplemental Security Income/State Supplementary Payment (SSI/SSP) cost-of-living adjustment. The maximum grant would increase from \$856 to \$892 for individuals and \$1,502 to \$1,565 for a couple.
- Includes \$54 million to implement Proposition 83 (Jessica's law); proposed expenditures are for conducting evaluations of sexually violent predators and additional staffing at the State Hospitals to implement the new program.
- Eliminates \$55 million in funding for the Integrated for Homeless Adults with Serious Mental Illness program and instead proposes to use Proposition 63 funding for this program.
- Includes \$36 million (\$17 million GF) to implement SB 437 – which requires the simplification of enrollment processes into the Healthy Families and Medi-Cal for children program.
- Provides an increase of \$1.6 billion General Fund (\$3.9 billion total) for enrollment, caseload, and population driven programs in the Health and Human Services area.

- Increases funding for Corrections and Rehabilitation by \$807 million. Of this amount, \$583 million is primarily for population and workload increases and \$363 million is for various infrastructure projects related to the administration's corrections reform package.
- Contains an increase of \$147 million for the Judiciary branch, primarily attributable to the year-to-year growth factor change in the State Appropriations Limit. This includes \$17 million for the State Judiciary and \$130 million for Trial Courts. The budget proposes to add 100 new judgeships over a two-year period beginning in April 2008 – the expenditure of funds for new judgeships is restricted until legislation authorizing new judgeships is enacted.
- Provides \$36 million (Motor Vehicle Account) to begin implementation of AB 32, Statutes of 2006 – Global Warming Solutions Act. This measure requires the State Air Resources Board to adopt a statewide greenhouse gas emissions limit equivalent to the levels in 1990; to be achieved by 2020.
- Proposes elimination of the Teacher Retention Tax Credit and to make permanent the requirement that use tax be paid if a vehicle, vessel or aircraft is brought into the state within 12 months of purchase – for an overall General Fund savings of \$200 million.
- Captures \$1.1 billion in Public Transportation Account (PTA) spillover funds and redirects the use of these funds for debt service on transportation bonds (\$340 million), home-to-school K-12 transportation (\$627 million), and transportation costs associated with developmentally disabled persons in state regional centers (\$144 million).
- Fully funds Proposition 42 and revenue is estimated to be \$1.5 billion – which is an increase of \$47 million over the revised 2006-07 estimate.
- Includes \$468 million General Fund to cover the 2007-08 cost increases associated with existing collective bargaining agreements and cost increases for excluded employees. Some of the costs result from a federal court order in the *Plata v. Schwarzenegger* corrections lawsuit. Only the Corrections bargaining unit is currently working without a contract.
- Includes a transfer of approximately \$2 billion to the Budget Stabilization Account, consistent with the Proposition 58 target for 2007-08 of two percent of General Fund revenues. Half of this amount is used to accelerate payment of the Economic Recovery Bonds (ERBs). In addition, the budget proposes a further repayment of \$595 million from the General Fund

## Strategic Growth Plan

The Governor's Budget Summary lays out his proposal to complete the Strategic Growth Plan (SGP) originally presented in 2006. The plan lays out the initial 10 years of a 20-year objective to focus on the state's infrastructure needs in the areas of transportation, K-12 and higher education, flood control and water supply, public safety, the courts, and other miscellaneous program areas. To fully complete this phase of the SGP, the administration is proposing a total of \$43.3 billion in new bonds -- \$29.4 billion in new general obligation bonds and \$13.9 billion of additional lease-revenue and self-liquidating revenue bonds; with the new General Obligation (GO) bonds placed on the ballot in the years 2008 and 2010. The use of these new bonds would

focus on education (K-12 / higher education), water supply, court facilities, and public safety (primarily prisons, jails, and local re-entry facilities).

In addition to the bond package, the Administration will require, prior to any funds being expended from existing or future bonds, the responsible state agencies to develop performance and outcome measures for each program or project that would be funded from the bonds. Regular audits will be conducted to ensure that bonds are being allocated according to those outcome criteria.